

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
Friday, February 15, 2002
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85012. Mr. Norman Miller, ASRS Board Vice Chairman, called the meeting to order at 8:39 a.m., MST.

The meeting was teleconferenced to the ASRS office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

1. Call to Order; Roll Call.

Present: Mr. Norman Miller, Vice Chairman
Dr. Chuck Essigs
Ms. Bonnie Gonzalez (via telephone)
Mr. Alan Maguire
Mr. Karl Polen (arrived at 8:40 a.m.)
Mr. Ray Rottas

Excused: Mr. Jim Bruner, Chairman
Dr. Merlin DuVal

Also Attending: Mr. N. Carl Tenney, Board nominee (awaiting confirmation)

A quorum was present for the purpose of conducting business.

Mr. Karl Polen arrived at 8:40 a.m.

Mr. Norman Miller, Vice Chairman, introduced Mr. Carl Tenney, who has been nominated to the Board by the governor and is awaiting confirmation from the senate. Mr. Tenney is a certified public accountant, worked for the City of Prescott for over 15 years, and is currently the Manager of the Town of Chino Valley. Mr. Tenney expressed his appreciation for the opportunity to serve on the Board. Mr. Karl Polen noted that he has served with Mr. Tenney in the past and welcomed him to the Board.

2. Approval of Minutes of the January 18, 2002, Regular Meeting of the ASRS Board.

Motion: Dr. Chuck Essigs moved to approve the minutes of the January 18, 2002, Regular meeting of the ASRS Board.

Ms. Bonnie Gonzalez seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

3. Board Approval of Consent Schedule.

Motion: Mr. Karl Polen moved that the ASRS Board approve the summary report of Retirements, Refunds and Death Benefits, and Transfer Requests.

Mr. Ray Rottas seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance for the period ending December 31, 2001

Mr. Terry Dennison, Principal, Mercer Investment Consulting, Inc. (Mercer), presented an economic and market review and reported on the Total Fund Performance for the period ending December 31, 2001.

Mr. Ray Rottas asked how the Enron failure has impacted the economy and the ASRS. Mr. Dennison replied that because Enron was an S&P 500 company there were significant losses in the market. However, the effect on the ASRS fund was minimal, given the diversity and magnitude of the portfolio. The long term impact of the Enron case will be changes in accounting standards and regulations, as well as stricter corporate policies on the auditing process.

Total Fund Performance for Period Ending December 31, 2001

| | Qtr | 1 Year | 3 Years | 5 Years | 10 Years |
|--------------------------------|------------|---------------|----------------|----------------|-----------------|
| Total ASRS Fund | 8.0% | -5.8% | 2.7% | 9.7% | 10.9% |
| Benchmark* | 6.9 | -7.2 | 0.5 | 7.9 | 9.4 |
| TUCS Public Fund Median | 6.5 | -5.2 | 3.1 | 8.3 | 9.9 |

*1/1/89-12/31/91 is 60% S&P 500/40% LB Aggregate
1/1/92-12/31/94 is 50% S&P 500/40% LB Aggregate/10% EAFE
1/1/95-6/30/97 is 45% S&P 500/40% LB Aggregate/15% EAFE
7/1/97-12/31/99 is 50% S&P 500/35% LB Aggregate/15% EAFE
1/1/00-Present is 53% S&P 500/30% LB Aggregate/17% EAFE

Performance vs. Benchmarks for the 3 Years Ending December 31, 2001

| | Return | Assumed ROR | Std. Dev. | Assumed Std. Dev. |
|------------------------|---------------|--------------------|------------------|--------------------------|
| Total ASRS Fund | 2.7% | 8.4% | 12.3% | 11.8% |
| Benchmark | 0.5% | | 11.0% | |
| Domestic Fixed | 6.2 | 5.6 | 3.9 | 5.3 |
| LB Aggregate | 6.3 | | 3.7 | |

| | | | | |
|--|-------------|------|--------------|------|
| Domestic Equity S&P 500 | 0.6 -1.0 | 9.4 | 18.6 18.2 | 16.3 |
| International Equity EAFE | 2.4 -4.8 | 10.0 | 20.4 17.4 | 21.5 |

Performance vs. Benchmarks for the 5 Years Ending September 30, 2001

| | Return | Assumed ROR | Std. Dev. | Assumed Std. Dev. |
|--|---------------|--------------------|------------------|--------------------------|
| Total ASRS Fund | 9.7% | 8.4% | 13.5% | 11.8% |
| Benchmark | 7.9% | | 12.3% | |
| Domestic Fixed LB Aggregate | 7.5 7.4 | 5.6 | 3.9 3.6 | 5.3 |
| Domestic Equity S&P 500 | 11.4 10.7 | 9.4 | 20.2 19.8 | 16.3 |
| International Equity EAFE | 5.3 1.2 | 10.0 | 21.4 20.1 | 21.5 |

5. Presentation, Discussion and Appropriate Action Regarding the Performance of Domestic Small Cap Equity Managers for the Period Ending December 31, 2001.

Mr. Terry Dennison, Principal, Mercer Investment Consulting Inc., reported on the following Investment Manager's performance for the Arizona State Retirement System: Axe-Houghton, Dimensional Fund Advisors, and Mellon Capital Management for the period ending December 31, 2001.

Mr. Seth Lynn, President, reported on Axe-Houghton and Associates' performance for the period ending December 31, 2001.

| | Quarter (12/31/01) | 1 Year | 3 Years | Since Inception (August 31, 1998) |
|-------------------------|-------------------------------|---------------|----------------|--|
| Style (Value Advantage) | -4.4% | 11.5% | 4.9% | 1.7% |
| Sector Selection | 0.0 | 0.0 | 0.0 | 0.0 |
| Stock Selection | 2.5 | 14.6 | 8.7 | 6.6 |
| Others | 0.0 | 0.0 | 0.0 | 0.0 |
| Fees | -0.1 | -0.1 | -0.1 | -0.1 |
| Total | -2.0 | 26.0 | 13.5 | 8.2 |

Mr. Lynn announced that Axe-Houghton sold the American Depositary Receipt (ADR) and domestic equity index disciplines, which includes the ASRS portfolio, to the Bank of New York. Mr. Lynn will work as a consultant to the Bank of New York for the next two years for the ADR portfolio, and continue to manage the small cap portfolio. After that time, he will transition to a newly formed company. Mr. Alan Maguire expressed concern about the transfer of technology and other information. Mr. Lynn reported that all equipment, office space, software, and resource research have been purchased by the new company, and transactions will continue without any interruptions. Mr. Maguire requested an update if any circumstances should change. Mr. Lynn answered that the ASRS staff has been and will continue to be updated weekly. Mr. Dennison added that a senior research analyst has reviewed the transaction, and because information between the Axe-Houghton units has not been shared, Mercer is comfortable with

the transaction.

Mr. Damon S. Fisher, Regional Director, and Mr. Robert T. Deere, Vice President and Portfolio Manager, reported on Dimensional Fund Advisors' performance for the period ending December 31, 2001.

| Total Rate of Return | Quarter (12/31/00) | 1 Year | 3 Years | Since Inception (August 31, 1998) |
|---|-------------------------------|---------------|----------------|--|
| Sector Selection | -3.43% | -8.74% | -0.25% | -0.39% |
| Stock Selection | 3.46 | 22.37 | 7.66 | 5.76 |
| Others*** | -0.26 | -0.36 | 0.45 | -0.80 |
| Fees (%) | -0.06 | -0.23 | -0.23 | -0.23 |
| Total Value Added Relative to Benchmark | -0.30 | 13.04 | 7.62 | 4.34 |

***Others - Turnover, trading experience and cash flow

Mr. Richard J. Forster, Managing Director, Marketing, and Ms. Susan Ellison, Managing Director, Equity Portfolio Management reported on Mellon Capital Management's performance for the period ending December 31, 2001.

| | Quarter (12/31/00) | 1 Year | 3 Years | Since Inception (August 31, 1998) |
|--------------------|-------------------------------|---------------|----------------|--|
| Stock Selection | -0.28% | 1.12% | 0.85% | 0.89% |
| Securities Lending | 0.01 | 0.07 | 0.08 | 0.09 |
| Cash Drag/Other | -0.05 | -0.01 | -0.01 | -0.04 |
| Fees | -0.01 | -0.03 | -0.03 | -0.03 |
| Value Added | -0.33 | 1.15 | 0.89 | 0.91 |

6. Director's Report

Mr. Karl Polen congratulated the ASRS management team on the results of the employee satisfaction survey, which were outstanding relative to the rest of the state employee group.

Mr. Richard Stephenson, Deputy Director, External Operations reported that the ASRS staff has successfully been working closely with legislators, legislative staff and the Governor's Office on necessary amendments to bills. Internally, the ASRS has formalized a process for developing administrative cost estimates on bills, tightened up the process of getting cost letters from the actuary, and has made incremental changes to the Weekly Report and disseminating it to all ASRS employers.

Mr. Tom Finnerty, Legislative Liaison, provided a progress report on ASRS-related bills that have been introduced.

- Staff has been working on an amendment to **SB 1004 (ASRS; spousal consent)**, which will be introduced by the bill sponsor, Senator Smith.

- Staff has spoken with Senator Bungaard, Chairman of the Senate Finance Committee, regarding **SB 1095 (ASRS; conforming changes; federal law)**, which brings state statutes up to date with recent changes in federal law. The senator has assured staff the bill will be on the February 25 committee agenda so that it can make it to the floor.
- The House Retirement and Government Operations Committee had **HB 2379 (ASRS; retirees; graded multiplier increase)**, which would give retirees with more than 20 years of service a percentage benefit increase based on the increases in last year's graded multiplier, and **HB 2558 (retirees; health insurance; enhanced subsidy)**, which extends the rural health insurance supplement for one year, on its February 19 agenda. However, because of the budget difficulties, all committee activity has been suspended for one week.

Mr. Miller asked staff to elaborate on their conversations with members of the legislature. Mr. Stephenson responded that staff has spoken with most of the members of the Senate Finance Committee and the House Retirement and Government Operations Committee, as well as the leadership of both houses, specifically on HB 2226, which proposes a split of the ASRS membership, and the accompanying HB 2219, which provides an early retirement window. In addition, all members of the legislature received a cost letter with summary cover of the impact of the proposals.

Mr. Alan Maguire requested information on the methodology used and the assumptions made in the actuary's cost letter for HB 2354 (deferred retirement option plans). He also suggested that the letter should have discussed, at length, alternatives to the proposed structure, rather than passively responding to the current legislation. He expressed concern about the cost and administrative consequences of dividing the ASRS membership (HB 2226) and the way the assumptions appear to have been made about the division of assets between the proposed tiers. Mr. Maguire also expressed worry about the precedent that may be set by having the Return to Work provision, which is a discretionary policy change by the legislature, included in SB 1095, a technical bill conforming to federal changes.

Mr. Maguire then commented he believes the ASRS Board needs to take a more proactive and more informative role in legislative matters dealing with substantial policy changes.

7. Board Requests for Agenda Items.

Mr. Maguire requested a report on changes in the ASRS senior management over the past 24 months and the efforts and activities that have occurred to replace senior people who have left.

8. Call to the Public.

Dr. Robert Letson, of Tucson, gave a history of the retirement benefit options and the ability to rescind any election. He would like to see legislation that retroactively allows all retirees to rescind their election.

Mr. Quentin Bogart, of the Arizona State University Retirees Association, introduced some members of the association, Mr. Gale Richards, Dr. John Bell, and Dr. Glenn Wilt and offered their expertise.

Mr. Maguire commented, for the record, that the ASRS Board should routinely conduct regular meetings at different locations around the state for the purpose of meeting and communicating better with employers

and members.

9. The next ASRS Board meeting is scheduled for Friday, March 15, 2002, at 8:30 a.m. in the Conference Room of the ASRS office at 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

10. Adjournment of the ASRS Board.

Mr. Norman Miller adjourned the February 15, 2002, meeting of the ASRS Board at 11:19 a.m.

Respectfully submitted,

Maurah Harrison, Secretary

Date

LeRoy Gilbertson, Director

Date